Sunfire Energy Corporation

1997 Annual Report

CORPORATE PROFILE

Sunfire Energy Corporation is an Alberta based company engaged in the exploration for and production of crude oil and natural gas.

The Company presently confines its exploration and development activities to a limited number of areas in Alberta where it has developed expertise. If possible, the Company maintains operatorship and markets its oil and gas production in order to maximize cash flow.

The Company's primary objective is to build shareholder value through the discovery of crude oil and natural gas reserves.

The Company is headquartered in Calgary and its common shares are listed on The Alberta Stock Exchange under the trading symbol **SFE.A**.

TABLE OF CONTENTS

Corporate Highlights	1
Report to Shareholders	2
Operations Review	3
Property Review	7
Financial Statements	11
Corporate Information	Inside Back Cover

ANNUAL GENERAL MEETING

Shareholders are invited to attend the Annual General Meeting of the Corporation which will be held in the Rideau Room at The Westin Hotel, 320 - 4th Avenue S.W., Calgary, Alberta on January 27, 1998 at 3:00 p.m.

HIGHLIGHTS

FINANCIAL

YEARS ENDED JULY 31	1997	1996
	$	$
Gross Revenue, less royalties	1,228,107	1,072,051
Cash flow from Operations	740,034	551,609
Per Share *	0.176	0.131
Net income	205,545	66,107
Per Share *	0.049	0.016
Capital Expenditures	1,292,274	1,015,686
Working Capital (Deficiency)	(443,976)	(190,507)
Shareholders' Equity	5,553,932	5,348,387
Number of Common Shares Outstanding	4,206,090	4,206,090

* Based upon the weighted average number of common shares outstanding during the fiscal year, namely 1997-4,206,090; 1996-4,223,998.

OPERATIONS

YEARS ENDED JULY 31	1997	1996
Production		
Crude Oil (Bbls/d)	34	43
Natural Gas (Mcf/d)	1,038	1,330
Reserves - Proven & Probable (net of royalties)		
Crude Oil (Mbls)	209	245
Natural Gas (Mmcf)	5,645	5,032
Present Value of Reserves		
(discounted at 15% before taxes)	$4,962,000	$5,225,000
Undeveloped Land Holdings		
Gross Acres	66,934	55,360
Net Acres	24,540	24,283

ABBREVIATIONS

Bbls	barrels
Bbls/d	barrels per day
Mbls	thousand of barrels
Mcf	thousand cubic feet
Mcf/d	thousand cubic feet per day
Mmcf	million cubic feet
ARTC	Alberta Royalty Tax Credit

REPORT TO THE SHAREHOLDERS

The fiscal year ended July 31, 1997, could be considered to have produced mixed financial and operating results. The Company's revenue benefited from much higher natural gas prices received under its long term sales contract. Consequently, revenues posted a 14% increase, while production volumes declined by 21%. Since operating costs were reduced, both cash flow and net income have recorded major improvements. Operations throughout the year were hampered by a scarcity of both drilling and completion rigs. This factor combined with an unusually wet spring and early summer delayed the Company's operations such that anticipated production gains from its core natural gas property at Thorhild were not achieved prior to the end of the fiscal year.

As the result of a number of strategic acquisitions, the Company has strengthened its production base at Thorhild. The Company now has working interests in over 60 sections of land as a contiguous block with ownership interest in two gas plants and over 100 kilometres of the associated gathering systems. With up to 11 separate gas zones to a depth of 850 metres, this property offers significant growth potential and will continue to generate solid cash flow well into the future.

Elsewhere the Company has established significant landholdings in a number of areas where there is the potential for the discovery of major oil and gas reserves. Recent competitive industry activity adjacent to these holdings supports this belief. In order to help fund exploration expenditures and reduce risk exposure a number of joint venture arrangements were concluded with industry partners whereby the Company was exposed to in excess of $1,000,000 of exploration expenditures at no cost, while maintaining meaningful residual working interests.

Management continues to believe that the greatest increase in shareholder value will ultimately come from successful exploration and development of its prospect inventory. During the forthcoming year the Company will acquire additional seismic data and drill several of these higher risk - high reward prospects. If appropriate, risk and financial exposure will be reduced by the inclusion of industry partners.

At year end, the Company approved a private placement of 700,000 flow through shares at a price of $0.65 per share. In addition to providing equity financing for the Company's exploration and development activities, this issue is also intended to improve liquidity and market support.

In conclusion, I would like to take this opportunity to thank our dedicated staff and service companies for their efforts during the past year, our Board of Directors for their advice and guidance, and our shareholders for their continued support.

John M. Westlake
President
December 10, 1997

OPERATIONS REVIEW

DRILLING

During the year ended July 31, 1997, the Company participated with an average 44% working interest in the drilling of 5 wells with the following results:

Drilling Activity in the Year ended July 31

	1997 GROSS (1)	1997 NET (2)	1996 GROSS (1)	1996 NET (2)
EXPLORATION				
Oil	0	0	0	0
Gas	5	2.21	2	0.71
Dry	0	0	0	0
	5	2.21	2	0.71
DEVELOPMENT				
Oil	0	0	1	0.23
Gas	0	0	2	0.57
Dry	0	0	2	0.88
	0	0	5	1.68
TOTAL	5	2.21	7	2.39

Notes:

(1) "Gross" wells means the number of wells in which the Corporation has a working interest

(2) "Net" wells means the aggregate of the numbers obtained by multiplying each Gross well by the Corporation's percentage working interest therein.

A horizontal well was drilled at Rainbow, at no cost to the Company, under a farmout agreement with industry partners. This well was completed as a Keg River oil well. The Company has a royalty interest which is convertable to a 37.5% working interest after payout of the well expenses from net revenue.

PRODUCTION

During the fiscal year ended July 31, 1997, the Company's natural gas production declined by 22% to a total of 379,023 Mcf from 486,886 Mcf. This volume is equivalent to a daily average of 1,038 Mcf for the year compared with an average of 1,330 Mcf/d in the prior year. The majority of the decrease in volume resulted from natural decline of the gas wells at Thorhild. The Company's net crude oil production has declined by 21% to a total of 12,419 Bbls from 15,659 Bbls in the previous year. This is equivalent to a daily production rate of 34 Bbls per day as compared to 43 Bbls per day in the prior year.

LAND HOLDINGS

In the reporting year, the Company expended $163,998 for the acquisition of 13,280 gross (7,721 net) acres of petroleum and natural gas rights from freehold owners and at Alberta Crown land sales. The average cost of the land acquisitions was $21 per acre. In addition to augmenting our holdings in existing core areas, land was acquired in several areas where new prospects are being explored.

Land Summary at July 31, 1997
(all lands are located in Alberta)

	GROSS [1] ACRES	NET [2] ACRES	ROYALTY [3] ACRES
UNDEVELOPED	66,934	24,540	960
DEVELOPED	32,800	9,006	7,760
	99,734	33,546	8,720

Notes:

(1) "Gross" refers to the total acres in which the Corporation has an interest.

(2) "Net" refers to the total acres in which the Corporation has an interest multiplied by the percentage working interest therein owned by the Corporation.

(3) "Royalty" refers to the total acres in which the Corporation has the right to receive a share of revenue as a royalty.

FINANCIAL ANALYSIS

Total production revenue for the fiscal year ended July 31, 1997, was $1,203,400 compared with $1,090,498 in the prior year. Increased natural gas prices more then offset production declines. The natural gas sales price increased to $2.10 per Mcf from $1.37 per Mcf in the prior year. The continued strength in international crude oil prices improved the wellhead price received by the Company for the sale of crude oil by 19% to an average of $27.95 per Bbl. For the year, the share of total production revenue provided by natural gas sales was 70% and by oil, 30%.

On an oil equivalent basis (BOE), utilizing 10 Mcf = 1 BOE, production and administrative expenses increased by 20% to $9.73 per BOE mainly due to lower levels of gas production. Netbacks, after royalties and operating costs, for natural gas increased to $1.38 per Mcf from $0.86 per Mcf due to higher natural gas prices, while the netback for crude oil improved to $18.11 per Bbl from $12.17 per Bbl due to both decreased operating costs and higher oil prices.

Cash flow for the year was up 42% at $740,034 compared to $522,369 in the previous year. This cash flow together with a bank credit facility and the proceeds of minor property dispositions was applied to capital expenditures of $1,292,274. These capital expenditures were directed to the following main categories (prior year's expenditures are indicated in brackets); drilling, completion and geophysics $676,080 ($673,485), purchase of petroleum and natural gas rights $445,321 ($141,766) and equipment and pipelines $131,469 ($126,646).

At July 31, 1997, the Company's working capital deficit was $443,976 and was financed by application of a credit facility of $600,000 available with a Canadian chartered bank.

PETROLEUM AND NATURAL GAS RESERVES

The Company's reserves were estimated as at August 1, 1997, by the independent petroleum engineering firm of Martin Petroleum & Associates Ltd. of Calgary. The volumes and estimated present value of the Company's proved and probable reserves, as determined by Martin, are shown in the following table. The values are forecast after the payment of operating expenses, capital costs and royalties, but prior to the payment of income taxes and indirect costs such as general and administrative expenses.

PETROLEUM AND NATURAL GAS RESERVES AND NET PRE-TAX CASH FLOWS
(Based on Escalating Price Assumptions)

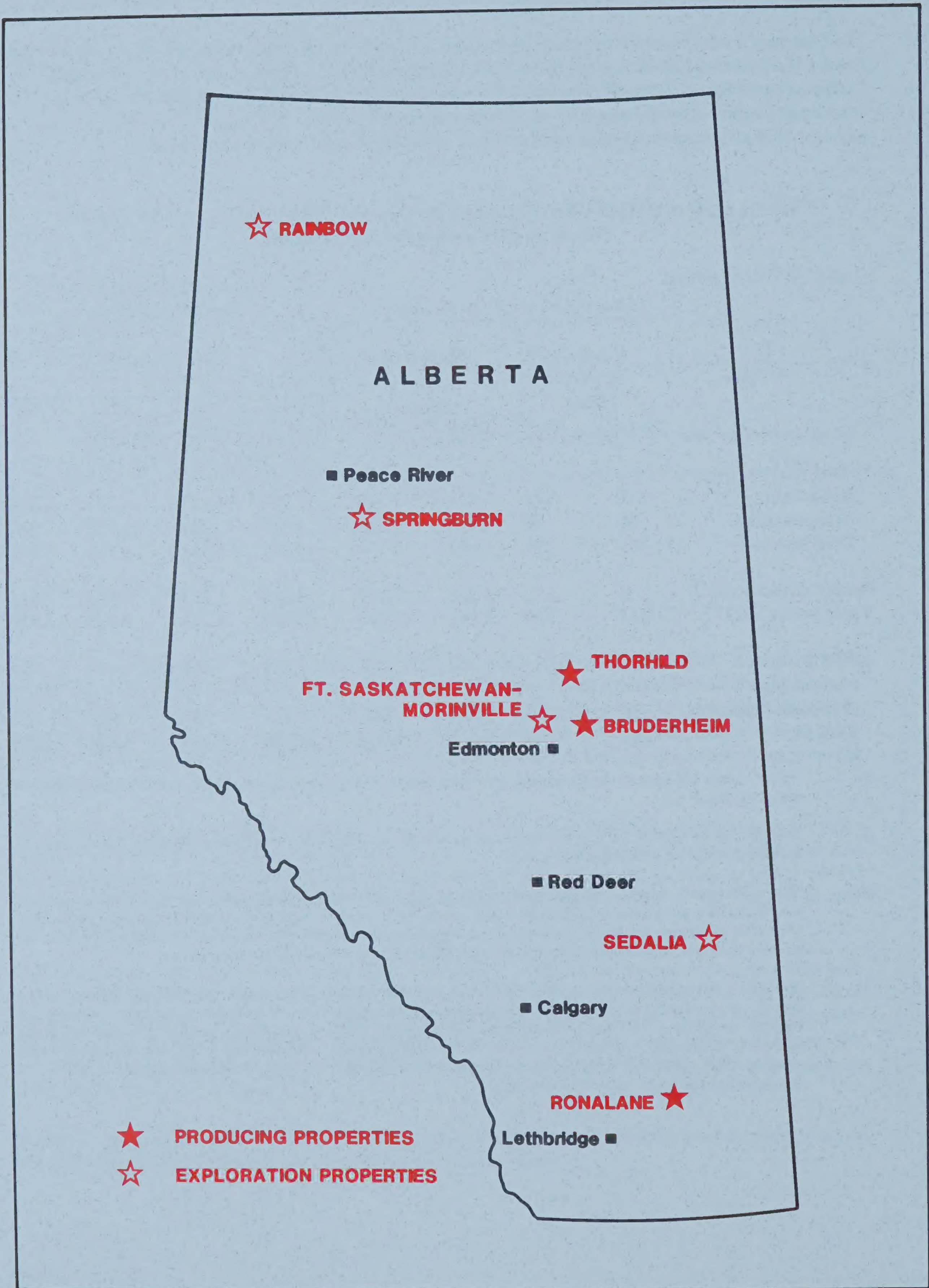
	Corporation's interest in reserves				Present worth of future net pre-tax cash flows			
	Crude Oil & NGLs (Mbls)		Natural Gas (MMcf)		Discounted at			
	Gross [1]	Net [2]	Gross [1]	Net [2]	0%	10%	15%	20%
					(thousands of $)			
Proved [3]								
Producing	145	121	3,952	3,348	13,395	3,843	2,983	2,460
Non-producing	98	88	1,746	1,448	4,746	1,601	1,168	906
Total Proved	243	209	5,698	4,796	18,141	5,444	4,151	3,366
Probable Additional [4]	0	0	2,048	1,697	3,996	1,284	854	611
Total before ARTC	**243**	**209**	**7,746**	**6,493**	**22,137**	**6,728**	**5,005**	**3,977**
ARTC					1,348	518	419	356
Less risking of Probable Additional	0	0	1,024	848	2,129	691	462	333
TOTAL	243	209	6,722	5,645	21,356	6,555	4,962	4,000

(1) "Gross" means the total of the Corporation's working interest and/or royalty interest share before deducting royalties owned by others.

(2) "Net" means the total of the Corporation's working interest and/or royalty interest share after deducting the amounts attributable to the royalties payable to others.

(3) "Proved Reserves" means those reserves estimated as recoverable under current technology and existing economic conditions, from that portion of a reservoir, which can be reasonably evaluated as economically productive on the basis of analysis of drilling, geological, geophysical and engineering data, including the reserves to be obtained by enhanced recovery processes demonstrated to be economic and technically successful in the subject reservoir.

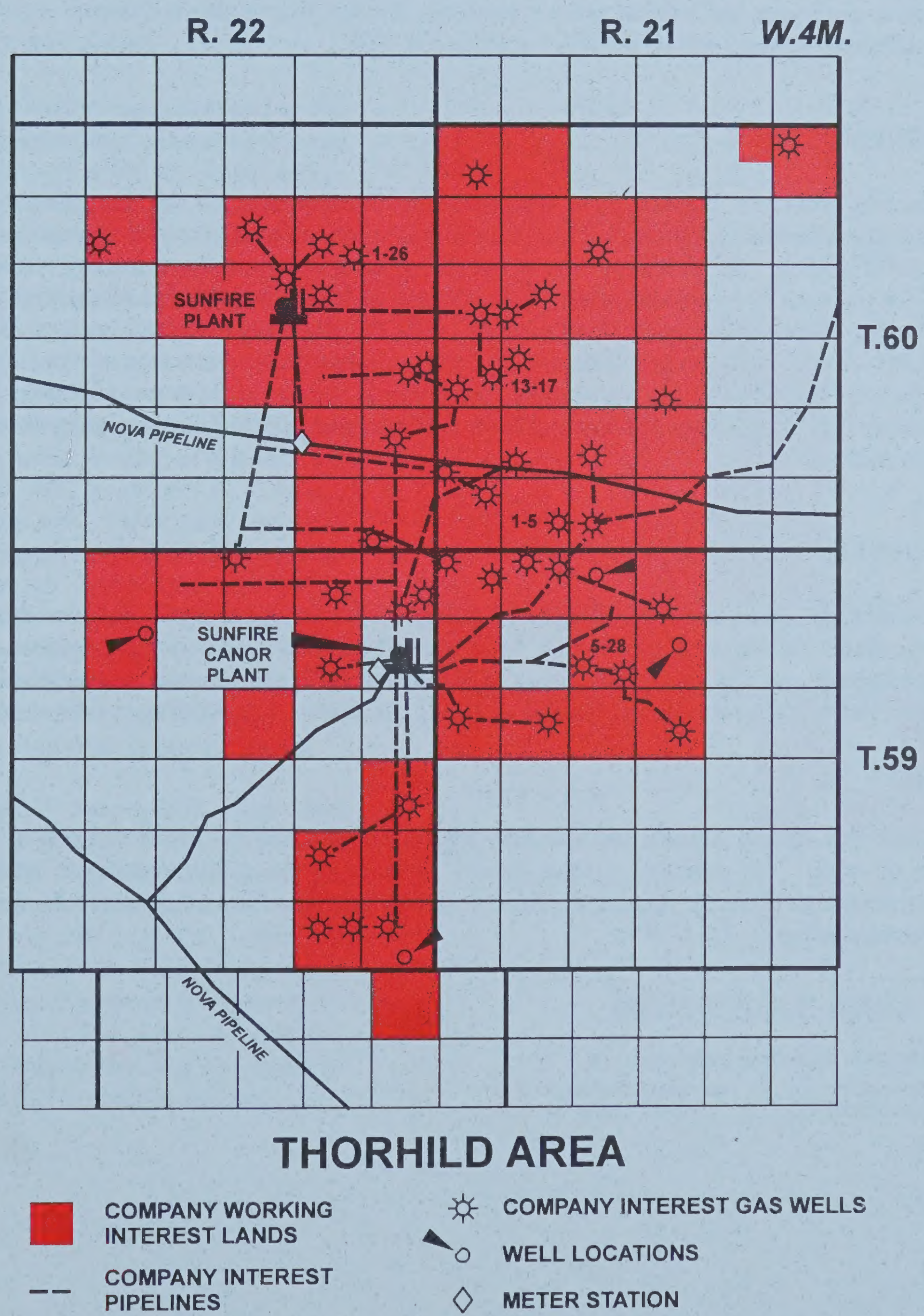
(4) "Probable Additional Reserves" means reserves which analysis of drilling, geological, geophysical and engineering data does not demonstrate to be proved under current technology and existing economic conditions, but where such analysis suggests the likelihood of their existence and future recovery. Probable additional reserves to be obtained by the application of enhanced recovery processes will be the increased recovery over and above that estimated in the proved category which can be realistically estimated for the pool on the basis of enhanced recovery processes which can be reasonably expected to be instituted in the future.


RAINBOW
ALBERTA
Peace River
SPRINGBURN
THORHILD
FT. SASKATCHEWAN-
MORINVILLE
BRUDERHEIM
Edmonton
Red Deer
SEDALIA
Calgary
RONALANE
Lethbridge
PRODUCING PROPERTIES
EXPLORATION PROPERTIES

PRODUCING PROPERTY REVIEW

THORHILD AREA

Almost all of the Company's natural gas production is obtained from the Thorhild area, located approximately 70 kilometres north of Edmonton. At year end, the Company had an average working interest of 20% in 24 producing gas wells. During the fiscal year, several acquisitions were made in the area by purchase, swap and takeover of well abandonment. These transactions resulted in increased plant interest, access to an additional 24 kilometres of the pipeline infrastructure, and an average 12% working interest in 12 producing or potentially productive gas wells.



THORHILD (Con't)

During December 1996, the Company participated in the acquisition of 46 kilometres of new seismic data. These data in conjunction with existing seismic data and well control, provided for the selection of 6 new exploratory well locations. The Company operated this program and participated for an average 40% working interest. Four of these wells were drilled in July 1997, resulting in three gas wells, namely 5-28, 13-17 and 1-26. Both 5-28 and 1-26 commenced production in October. It is anticipated these wells will contribute in excess of 500 Mcf per day to the Company's gas production. In March, the Company assumed responsibility for the abandonment of the 1-5 well from a third party. Upon recompletion in a previously ignored zone, this well has averaged 250 Mcf per day (net 85 Mcf per day).

The remaining two wells of the six well program will be drilled prior to the end of 1997. In addition the Company will participate for a 6.25% working interest in two shallow wells proposed by Canor Energy. Recompletion work on depleted gas wells and the tie-in of existing shut-in gas wells will also be undertaken as equipment and services become available. Further seismic data acquisition is planned and as a result additional locations will be selected for drilling in 1998.

BRUDERHEIM

Oil production from the Ellerslie pool discovered by the Company in 1989 continues to decline. Disappointing production performance from recently drilled oil wells has provided little encouragement to continue infill drilling. As a consequence of the foregoing assessment, the Company made its interest available for purchase by interested parties. This sale was successfully concluded subsequent to the end of the fiscal year. After disposition of the producing lands, the Company will continue to hold an average 44% in 4,000 acres of undeveloped lands and its extensive seismic data (in excess of 400 kilometres). In light of the knowledge of the area acquired by experience in the past eight years, additional well control and greater availability of crown and freehold land, the Company will continue to explore the area for new oil and gas pools.

SOUTH JOFFRE

At South Joffre, 10 kilometres east of Red Deer, a previously shut-in Viking oil well was recompleted in the deeper Basal Quartz zone and tied-in to a Blue Range operated gathering system. This well commenced natural gas and liquids production in November 1996, and subsequently declined rapidly due to depletion, production problems and the high operating pressure of the gathering system.

RONALANE

At Ronalane, in Southern Alberta, the Company retains a high working interest (52.5%) in a producing Sawtooth oil well. The operator, Crestar Energy, is currently upgrading equipment with a view to improving pumping efficiency. During the fiscal year, this well contributed 8 Bbls/d to the Company's oil and liquids production.

NEW EXPLORATION AREAS

As the result of aggressive land acquisition based upon the Company's large seismic data base, the Company has developed a number of exploration prospects.

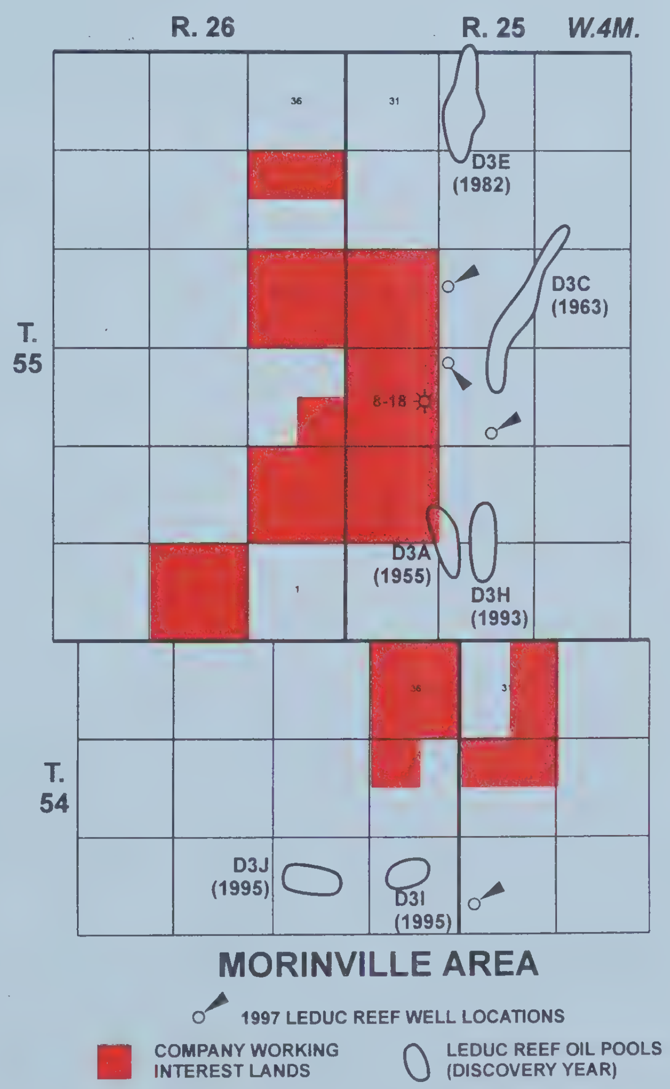
FORT SASKATCHEWAN

Landholdings were increased by 2,720 acres to 6,080 acres during the past fiscal year. Cost recoveries by reducing the Company's working interest to 80% were expended on the acquisition of 14 kilometres of new seismic data. At present, it would appear that these landholdings have three separate Lower Cretaceous oil and / or gas prospects at depths to 1,100 metres. Similar features further to the west have produced prolific gas wells with recoverable reserves in the range of 3 to 8 BCF per well. Once seismic evaluation is complete, a location for an initial exploratory well will be selected.

MORINVILLE (Cardiff)

A great deal of effort was expended on the Morinville landholdings where Leduc age reefs at depths of 1,400 to 1,600 metres offer attractive prospects. An additional 110 kilometres of trade seismic data was purchased and reprocessed. The resulting interpretation indicated a closed culmination on the Leduc reef rim at 8-18-55-25 W4M. An exploratory well was drilled directionally in June to a depth of 1,440 metres. Unfortunately the Leduc reef proved to be water bearing at this location and the well was completed as a Lower Cretaceous gas well. Subsequent testing of the gas zones indicated insufficient reserves at this time to justify the cost of a production infrastructure. The Company's share of the funding for the foregoing seismic evaluation and drilling of the 8-18 well was provided for by a disposition of a 45% working interest to industry partners.

Interpretation of the seismic data also revealed the possibility of three additional locations on the Company's landholdings. These features will be evaluated by the acquisition of new seismic data in December. During the year, landholdings were increased to 9 sections (5,760 acres) by the addition of 1,760 acres of freehold leases. The Company operates this property and maintains a 55% working interest.



MORINVILLE (Cardiff) (Con't)

Industry activity in the area has increased substantially in recent months with the drilling of 4 new wells adjacent to the Company lands. Part of this interest in the area has been generated by a series of Leduc reef discoveries that were made over the past four years. Production from these new wells ranges from 40 to over 250 Bbls per day of light gravity oil. The higher production rates are usually free of associated water production and therefore these wells generate impressive cash flows. Potential pay zones have varied in thickness from 2 metres to 39 metres, and recoverable oil reserves for a typical reservoir in this area with 20 metres of pay would be in the order of 500,000 Bbls per 40 acre spacing unit.

Once the new seismic program is evaluated, it may be necessary to follow up with three dimensional seismic data to provide the optimum drilling location. If this is necessary, it is anticipated drilling would be undertaken in late May or June 1998.

RAINBOW

Within the confines of the Rainbow oilfield, the Company holds an average 47% interest in 2,560 acres. The majority of these lands were selected by utilizing the Company's extensive seismic data base in the area. In view of the high costs associated with drilling at Rainbow, the ultimate purpose of the acquisitions was to solicit interest from industry partners to undertake the evaluation of lands acquired.

During the past year the Company benefited from a horizontal well that was drilled in December 1996 and a 10 square kilometre three dimensional seismic program acquired in March. The horizontal re-entry well at 10-25-111-6 W6M drilled through over 500 metres of porous Keg River reef. The well was completed and placed on production in February. Initial rates of production have not exceeded 50 Bbls per day and the well was shut-in due to restricted access at the beginning of April. Production is anticipated to be restarted in December when the surface access is frozen. The Company has a royalty interest until payout of the expenses associated with the drilling and completion of the well. After payout is achieved, the royalty can be converted to a 35% working interest.

The three dimensional seismic program was undertaken over two sections owned 55% by the Company. Initial interpretation indicates the presence of a small Keg River reef anomaly. As a consequence of the seismic expenditure, the Company's working interest was reduced to 44%. In the forthcoming year efforts will be made to have this prospect drilled.

SPRINGBURN (Dawson)

The Springburn or Dawson area is located approximately 60 kilometres southeast of the town of Peace River. Recent drilling activity in the area led by Amber Energy has resulted in a number of prolific light gravity oil discoveries in the Devonian age Slave Point reefs fringing the Peace River arch. Initial test rates in excess of 500 Bbls per day have been reported. Within the scope of this play, the Company has total landholdings of 10,400 acres, comprising eight strategically located 160 acre leases with a 52% working interest surrounded by 9,120 acres held jointly with Amber in which the Company has a 15% working interest. Within the lands are a number of abandoned wells drilled in the 1950's and 1980's which produced over 700,000 Bbls of oil from Slave Point and underlying Granite Wash zones. It is anticipated that drilling activity directly offsetting the Company landholdings will increase dramatically during the forthcoming winter.

MANAGEMENT'S REPORT

The accompanying consolidated financial statements are the responsibility of management and have been prepared in accordance with accounting principles generally accepted in Canada.

Management acknowledges responsibility for the integrity of the consolidated financial statements and all other financial information in this annual report. Where appropriate, management has made informed judgments and estimates in accounting for transactions which affect the current accounting period but cannot be finalized with certainty until future periods. Company policies and procedures have been implemented to reasonably ensure that transactions are appropriately authorized, assets are safeguarded from loss and financial records are properly maintained. To further minimize risk, management maintains adequate systems of internal control.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and has appointed an Audit Committee. This committee, consisting of a majority of non-management directors, meets with management and external auditors to ensure that each group is properly discharging its responsibilities and to discuss internal control, accounting policies and financial reporting matters. The Audit Committee has reviewed the consolidated financial statements and has reported thereon to the Board of Directors. The Board of Directors has approved the consolidated financial statements for issuance to the Shareholders.

J.M. Westlake
President

P.W. Goodman
Secretary Treasurer

AUDITORS' REPORT

To the shareholders of Sunfire Energy Corporation

We have audited the consolidated balance sheets of Sunfire Energy Corporation as at July 31, 1997 and 1996 and the consolidated statements of operations and changes in financial position for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We have conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at July 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Henrickson & Shannon

CHARTERED ACCOUNTANTS

Calgary, Canada
October 23, 1997

SUNFIRE ENERGY CORPORATION

CONSOLIDATED BALANCE SHEETS

July 31, 1997 and 1996

	1997 $	1996 $
ASSETS		
CURRENT ASSETS		
Cash	**8,032**	44,352
Receivables	**883,433**	900,474
Prepaid expenses	**2,768**	4,673
	894,233	949,499
CAPITAL ASSETS (Note 2)	**6,586,812**	5,996,994
	7,481,045	6,946,493
LIABILITIES		
CURRENT LIABILITIES		
Bank indebtednes (Note 3)	**18,825**	-
Payables and accruals	**1,319,384**	1,140,006
	1,338,209	1,140,006
PROVISION FOR FUTURE SITE RESTORATION	**77,204**	68,300
DEFERRED INCOME TAXES	**511,700**	389,800
	1,927,113	1,598,106
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 4)	**4,065,517**	4,065,517
RETAINED EARNINGS	**1,488,415**	1,282,870
	5,553,932	5,348,387
	7,481,045	6,946,493

See accompanying notes

Approved by the Board:

Peter W. Goodman, Director

John M. Westlake, Director

SUNFIRE ENERGY CORPORATION

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

YEARS ENDED JULY 31, 1997 AND 1996

	1997 $	1996 $
REVENUE		
Petroleum and natural gas sales	**1,203,400**	1,090,498
Less Royalties, net of tax credits	**(172,395)**	(165,741)
	1,031,005	924,757
Interest and other income	**197,102**	147,294
	1,228,107	1,072,051
EXPENSES		
General and administrative	**206,898**	194,515
Well operating expenses	**282,585**	327,854
Depletion	**411,179**	436,475
	900,662	958,844
INCOME BEFORE TAXES	**327,445**	113,207
DEFERRED INCOME TAXES (Note 5)	**121,900**	47,100
NET INCOME FOR YEAR	**205,545**	66,107
RETAINED EARNINGS BEGINNING OF YEAR	**1,282,870**	1,216,763
RETAINED EARNINGS END OF YEAR	**1,488,415**	1,282,870
NET INCOME PER SHARE		
Basic	**4.9 ¢**	1.6 ¢
Average common shares outstanding (Note 1f)	**4,206,090**	4,223,998

See accompanying notes

SUNFIRE ENERGY CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

YEARS ENDED JULY 31, 1997 AND 1996

		1997 $	1996 $
CASH DERIVED FROM (APPLIED TO)			
OPERATING ACTIVITIES			
Net income for year		**205,545**	66,107
Items not requiring cash outlays			
Amortization and depletion		**412,589**	438,402
Deferred income taxes		**121,900**	47,100
	*	**740,034**	551,609
Changes in other working capital elements		**198,325**	(142,209)
		938,359	409,400
FINANCING ACTIVITIES			
Share capital reacquired		**-**	(22,460)
INVESTING ACTIVITIES			
Expenditures on oil and gas properties and equipment		**(1,292,274)**	(1,015,686)
Proceeds from sales of oil and gas properties		**298,770**	247,407
Notes receivable repayments		**-**	12,310
		(993,504)	(755,969)
NET DECREASE IN CASH		**(55,145)**	(369,029)
CASH BEGINNING OF YEAR		**44,352**	413,381
CASH (DEFICIENCY) END OF YEAR		**(10,793)**	44,352
COMPONENTS OF CASH (DEFICIENCY)			
Cash		**8,032**	44,352
Bank indebtedness		**(18,825)**	-
		(10,793)	44,352
CASH FLOW FROM OPERATIONS PER SHARE	*	**17.6¢**	13.1¢

See accompanying notes

SUNFIRE ENERGY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JULY 31, 1997

1. SIGNIFICANT ACCOUNTING POLICIES

a. Principles of consolidation

The consolidated financial statements include the accounts of the company and its wholly-owned subsidiary Freeman Energy Ltd. All material intercompany balances, transactions and profits have been eliminated.

b. Joint venture activities

Substantially all of the company's exploration and production activities are conducted jointly with others and the accounts reflect only the company's proportionate interest in such activities.

c. Capital assets

Oil and gas properties and equipment

The company follows the full cost method of accounting for oil and gas operations whereby all costs associated with the acquisition of, exploration for, and development of oil and gas reserves are capitalized. Such amounts include lease acquisition, geological and geophysical exploration, carrying charges for unproved properties, costs of drilling both productive and non-productive wells, and administrative overhead related to exploration and development activities. Proceeds from the disposition of properties are applied as a reduction of capitalized cost, unless the depletion and amortization rate would change by a factor of 20% or more, whereupon gains or losses are recognized in income.

Depletion and amortization of these costs, including provision for future site restoration and abandonment expenditures, is provided by using the unit-of-production method based upon proved reserves, with gas and oil converted to energy equivalent units. The costs of significant unevaluated properties are not included in the base.

Capitalized costs of oil and gas assets are subject to a ceiling test calculation whereby the carrying value is limited to the future net revenue from production of proved reserves based on current prices, costs, and the value of unproven properties at the lower of cost or net realizable value.

Furniture and office equipment

Furniture and office equipment is recorded at cost and amortized using the declining balance method at the following annual rates: Furniture - 20%, Computer equipment - 30%, Computer software - 100%

d. Future site restoration and abandonment

Estimated future costs of restoring oil and gas properties are estimated each year by management based on current regulations, technology and industry standards. The annual provision is included in depletion expense and actual site restoration and abandonment costs are charged to the accumulated provision account as incurred.

e. **Flow-through shares**

The resource expenditure deductions related to exploration and development activities, funded by flow-through share arrangements, are renounced to investors in accordance with current tax legislation. Funds expended are capitalized and cash received from subscribers recorded as share capital.

f. **Per share data**

Cash flow from operations and net income per share are calculated based on the weighted average number of shares outstanding during the year. There would be no significant dilutive effect as a result of the share options being exercised.

g. **Measurement uncertainty**

The amounts recorded for depletion and amortization of property and equipment and the provision for future site restoration costs are based on estimates. The ceiling test calculation is based on estimates of proved reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes in such estimates in future periods could be significant.

2. **CAPITAL ASSETS**

	1997 $	1996 $
Petroleum and natural gas properties and equipment	9,419,925	8,426,421
Furniture and office equipment	33,127	33,127
	9,453,052	8,459,548
Less accumulated depletion and amortization	(2,866,240)	(2,462,554)
	6,586,812	5,996,994

Unevaluated properties with a cost of $951,204 (1996 - $870,952), included in petroleum and natural gas properties, have not been subject to depletion. Administrative overhead capitalized during the year amounted to $75,756 (1996 - $75,756).

3. **BANK INDEBTEDNESS**

Bank indebtedness consisting of a current account overdraft is supported by assignments of book debts, general security agreement and a demand debenture. The company has a line of credit to $600,000 with interest at prime bank lending rate plus 1/2%.

4. **SHARE CAPITAL**

a. **Authorized**
Unlimited number of Class A voting common shares
Unlimited number of Class B non-voting common shares
Unlimited number of Class C, D and E preferred shares

b. **Issued and outstanding**

Class A shares	Number of Shares	Amount $
Balance July 31, 1994	4,278,090	4,096,221
Repurchase of shares	(16,500)	(8,244)
Balance July 31, 1995	4,261,590	4,087,977
Repurchase of shares	(55,500)	(22,460)
Balance July 31, 1997 and 1996	4,206,090	4,065,517

c. **Flow-through shares**

On July 22, 1997, the company commenced the private placement of 700,000 flow-through Class A common shares at $0.65 per share. As described in Note 1, certain resource expenditure deductions, funded by flow-through shares arrangements are renounced to investors in accordance with income tax legislation.

d. **Stock options**

Under an incentive stock option plan, the company has granted 345,000 stock options to directors and employees of the company. The stock options are exercisable at $0.70 per share and will expire February 13, 2002.

5. INCOME TAXES

	1997 $	1996 $
Income before income taxes	**327,445**	113,207
Expected taxes at combined federal and provincial statutory rates of approximately 44.6%	**146,100**	50,500
Increase (decrease) resulting from:		
Non-deductible Crown charges	**49,800**	41,500
Alberta Royalty Tax Credits	**(31,200)**	(30,600)
Federal resource allowance	**(35,900)**	(19,300)
Other	**(6,900)**	5,000
Deferred income taxes	**121,900**	47,100

The company has approximately $5,276,000 of income tax pools available to offset future taxable income.

6. RELATED PARTY TRANSACTIONS

The company conducts business with Hi-Tech Exploration Services Ltd. and Harlech Exploration Ltd. (companies owned by an officer of the corporation) on the same terms and arrangements as transactions with outsiders. At July 31, 1997 receivables from these related parties amounted to $36,464 (1996 - $11,106) and payables to these companies amounted to $ NIL(1996 - $1,062).

7. COMMITMENTS AND SUBSEQUENT EVENTS

Cash received subsequent to the year end from subscriptions for flow-through shares amounted to $455,000.

Also subsequent to the year end, the company sold certain interests in producing properties for net proceeds of $350,000.

On August 1, 1997 the company entered into a lease agreement for office premises ending July 31, 2000. Minimum lease payments under the lease are as follows: 1998 - $14,650, 1999 - $15,870, 2000 - $16,480.

NOTES

NOTES

NOTES

CORPORATE INFORMATION

OFFICERS

John M. Westlake
President and Chief Executive Officer

Peter W. Goodman
Vice-President and Secretary-Treasurer

DIRECTORS

* Roderick Campbell
Calgary, Alberta
President of Foxwood Resources Ltd.

* Peter W. Goodman
Cochrane, Alberta
Vice-President and Secretary of
Sunfire Energy Corporation

Christian Lemmer
Calgary, Alberta
President of Lemmer Spray Systems Ltd.

* Lionel A. Singleton
Calgary, Alberta
President of Singleton Resources Ltd.

John M. Westlake
Calgary, Alberta
President and Chief Executive Officer of
Sunfire Energy Corporation

* *Member of Audit Committee*

CORPORATE AND REGISTERED OFFICE

550, 700 - 6th Ave. S.W.
Calgary, Alberta T2P 0T8
Telephone: (403) 290-1785

AUDITORS

Henrickson & Shannon
Calgary, Alberta

BANKERS

Hongkong Bank of Canada
Calgary, Alberta

EVALUATION ENGINEERS

Martin Petroleum & Associates
Calgary, Alberta

LEGAL COUNSEL

Bennett Jones Verchere
Calgary, Alberta

Code Hunter Wittman
Calgary, Alberta

STOCK EXCHANGE LISTING

The Alberta Stock Exchange
Trading Symbol SFE.A

SUBSIDIARY COMPANY

Freeman Energy Ltd.
Calgary, Alberta

TRANSFER AGENT AND REGISTRAR

Montreal Trust
Calgary, Alberta

SUNFIRE ENERGY CORPORATION
550, 700 - 6th Ave. S.W.
Calgary, Alberta
T2P 0T8

Telephone: (403) 290-1785
Facsimile: (403) 269-4349
email: sunfire@cadvision.com